

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

CONFIRM

Docket No. MC2002-1

COMMENT OF UNITED STATES POSTAL SERVICE
IN SUPPORT OF SETTLEMENT
(July 9, 2002)

In accordance with Presiding Officer's Ruling No. MC2002-1/4, the Postal Service hereby provides this Comment in support of settlement of the instant case.

I. Procedural History

On April 24, 2002, the United States Postal Service filed with the Postal Rate Commission ("Commission") the Request of the United States Postal Service for a Recommended Decision on Classification and Fees for Confirm ("Request"). The Request was filed in accordance with 39 U.S.C. §§ 3622 and 3623.

The Request was based on the establishment of a new service, designated "CONFIRM", that uses a new form of barcode ("PLANET Codes") in connection with mail processing to help mailers track the flow through mail processing operations of automation-compatible letter-size and flat-size mail pieces. The Postal Service proposed the creation of a permanent Confirm service and classification, with corresponding fees, and also proposed certain changes in the Domestic Mail Classification Schedule ("DMCS"). The Postal Service supported its request with the written direct testimony of five witnesses

and other documents, including exhibits and workpapers, submitted pursuant to the Commission's Rules of Practice and Procedure. 39 C.F.R. §§ 3001.1 *et seq.*

The Postal Service estimated that its test year (FY 2003) revenues would total \$9.2 million, and its total costs would be \$5.0 million, creating projected test year net income of \$4.2 million. Furthermore, the estimated net income from CONFIRM would not materially affect the cost and revenue projections for FY 2003 in Docket No. R2001-1.

By Order No. 1339, issued on April 29, 2002, the Commission noticed the Postal Service's Request and designated the instant proceeding as Docket No. MC2002-1. The Commission gave interested parties until May 16, 2002, to intervene in the proceeding, and designated Shelley S. Dreifuss, then Acting Director of the Office of the Consumer Advocate ("OCA"), to represent the general public. Five parties have intervened in this proceeding.

On May 20, 2002, the Postal Service held a Settlement/Technical Conference attended by representatives from three of the five intervenors and the OCA. Those preliminary negotiations led to a draft Stipulation and Agreement ("Agreement") that was subsequently revised. As a result of ongoing negotiations with all participants, a near unanimous final Agreement was produced.¹ That Agreement was filed with the Commission on June 21, 2002.

The Agreement, as filed, proposes that the Commission recommend a permanent classification for CONFIRM and associated fees for approval by the Governors of the United States Postal Service, essentially mirroring the original

¹ Only David B. Popkin failed to join the settlement; however, he also indicated that he did not oppose settlement.

Request's fees. However, the DMCS language attached to the Agreement differs from the DMCS language originally requested. The Commission initiated discussion of differing DMCS language through the issuance of Notice of Inquiry No. 1 (May 16, 2002). That discussion proved quite productive and resulted in new DMCS language that ultimately became one of the bases for the Settlement Agreement. For reasons explained more completely in the Postal Service response to NOI-1,² that new DMCS language incorporates some of the Commission's NOI-1 suggestions, the original proposed DMCS language, and additional understanding reached by a comparison of the two as well as settlement discussions. It bears emphasizing that the Agreement reflects the concurrence of the signatories that, for the purpose of this proceeding, the Postal Service's Request, testimonies, and supporting documentation provide substantial record evidence sufficient to serve as the basis for the Commission's recommendations to the Governors. Stipulation and Agreement at ¶ 2.

On June 24, 2002, the Commission issued POR No. MC2002-1/4 that, among other things, vacated the procedural schedule established by POR No. MC2002-1/1 and adopted a revised schedule for the conclusion of this proceeding. The revised schedule requires parties to designate direct testimonies and written cross-examination, supported by appropriate declarations for inclusion in the evidentiary record, and the filing of a "comment" in support of settlement.

² See Comments of United States Postal Service on Notice of Inquiry No. 1 Concerning Proposed DMCS Changes, June 7, 2002.

II. The Commission Should Recommend the Nearly Unanimous Settlement Agreement.

A. Confirm Provides Operational Benefits to the Mailing Community and the Postal Service.

Confirm was developed in response to a desire expressed by the mass mailer community for the Postal Service to provide delivery status information for mail pieces. The functionality of Confirm has been developed with input from internal customers as well as the mailing industry via the Mailer Technical Advisory Committee ("MTAC"). In 1998, the Postal Service began a pilot program to test the prototype system. USPS-T-1, at 8-9. As of June 3, 2002, 275 mailers had applied to participate in Confirm.³ Confirm is, therefore, truly a service the market demands.

Confirm uses a new barcode technology called PLANET Code to help mailers track automation-compatible letter size and flat mail pieces. USPS-T-1, at 2. Mailers use Confirm information to learn when outgoing mail (Destination Confirm) is nearing delivery or when reply pieces (Origin Confirm) have been mailed and are on their way. *Id.* at 1. Ultimately, the goals of Confirm are to help mailers manage their businesses better and enhance relationships with their customers, while providing the Postal Service with information that may be used to enhance operational efficiency. *Id.* at 7. Moreover, Confirm is a completely passive data collection system and as such will have no significant impact on the way that mail is processed. *Id.* at 10.

³ See response to APWU/USPS-T1-3, filed on June 12, 2002.

B. Confirm Enhances Our Mailers' Customer Relationships.

As previously stated, Confirm was developed largely in response to customer demand. The mailer community seeks more information relevant to their mail, and wants the Postal Service to make their mail processing operations more transparent or visible.⁴ To that end, Confirm was born.

The mailing community is beginning to realize the full range of Confirm's benefits. Early applications include using destination Confirm to obtain good estimates of when mailings will be delivered, allowing mailers to coordinate their marketing efforts. USPS-T-2, at 7. Similarly, origin Confirm supports a mailer's cash flow management and allows faster processing of purchases and information requests by informing the Confirm customer that a mail piece will be arriving shortly. *Id.*

C. Witness Nieto Provides Conservative Cost Estimates of Confirm in the Test Year.

Witness Nieto, USPS-T-3, estimates the product specific and volume variable costs caused by Confirm in the test year using a conservative, methodical approach that knits together sound economic theory and Commission precedent. She started by consulting the developers, support personnel and managers to learn how Confirm works. Using this knowledge, she then identified each resource used in the production and delivery of Confirm, including technology, maintenance and program management. By applying the principle of cost causality, witness Nieto then determined which costs were caused by the existence of Confirm. Respective product specific and volume

variable cost components were distinguished by determining which cost components varied with a change in volume. Costs not caused by Confirm and not associated with a change in Confirm volume were excluded from analysis. This approach then permitted witness Nieto to accumulate costs caused by Confirm across cost pools to calculate unit costs. USPS-T-3, at 4-7.

Confirm has four main cost components: information technology, program support, field support, and marketing. Each of these consists of sub-elements witness Nieto refers to as cost pools. The information technology component includes depreciation of software, hardware, and system development expenditures. The program support component includes dedicated program management and consulting contractor support. The field support component includes field technology chargebacks, helpdesk costs, and any attributable shared infrastructure costs in the field. The marketing component includes advertising expenditures and costs for various marketing services and promotional activities. USPS-T-3, at 2.

Witness Nieto estimates that total incremental costs for Confirm in the test year amount to \$5,034,335, of which \$1,092,093 are volume variable. USPS-T-3, at 3, 4. Witness Nieto's volume variable cost estimates necessarily rely upon volume projections. See, e.g., section V(A)(3), *Volume Variable Hardware and Software Cost Projections*, USPS-T-3, at 10-13. The volume projections relied upon by witness Nieto were presented by witness Rothschild (see Input Sheet A-3, USPS-LR-2/MC2002-1) who projected a total of 1,126 Confirm

⁴ Direct testimony of Joe Lubenow, USPS-T-2, at 1 (see discussion of "Black Box" versus "Glass Box" theory).

subscriptions, consisting of 111 Silver, 654 Gold, and 361 Platinum. USPS-T-4, at 8.

D. Witness Rothschild Provides Conservative Estimates of Demand for Confirm.

The Postal Service engaged the services of witness Rothschild, and her firm National Analysts, Inc., to conduct market research estimating customer demand among firms that enter large volumes of First-Class Mail or Standard Mail for a Confirm service that consists of three subscription levels. Witness Rothschild followed through with a thorough, accurate, and conservative survey that focused upon two types of firms, ones that entered First-Class Mail and/or Standard Mail in FY2000 while incurring permit imprint expenses greater than \$500,000, and ones who at some time registered with an earlier version of Confirm. Companies that enter only their own mail as well as companies that enter others' mail (resellers) were included.⁵ USPS-T-4, at 3-4.

The sample design started with Postal Service high volume business locations (First-Class Mail or Standard Mail) and 561 Confirm registrants. These two were merged and de-duplicated, and the combined file was stratified into four groups: 1) registrants, 2) First-Class Mail only, 3) Standard Mail only, and 4) mailers of both First-Class Mail and Standard Mail. USPS-T-4, at 4.

Witness Rothschild made use of a Computer Assisted Telephone Interview (CATI) system, which has the advantages of permitting programmatic logic and consistency checks to control the flow of an interview. Experienced

⁵ The introduction of discounted rates created an industry that aggregates and prepares mail to qualify for those discounts. Confirm is expected to become another service offered by such firms to their customers. See USPS-T-2, at 11-12.

CATI interviewers conducted the interviews, and an extensive system of interviewer training and quality control procedures was employed to ensure that accurate data were collected. The 684 interviews used in the final analysis were properly weighted so that the results accurately reflected all mailers in the sample frame. USPS-T-4, at 4-7.

Survey respondents were asked the likelihood of their purchasing at least one subscription on a scale from 0 to 100 percent. The Postal Service determined that only those respondents who indicated at least an 80 percent likelihood of purchasing at least one subscription would be included in the estimates. USPS-T-4, at 7. This was chosen as a conservative threshold to provide assurance that overestimation of Confirm usage would be avoided. Moreover, the calculation of actual projected subscriptions used each respondent's reported likelihood of use (rather than one), *id.*, thereby providing additional assurance that overestimation was avoided.

Witness Rothschild's survey research generated the following estimates of demand for Confirm at the lower price point tested (derived from table appearing in USPS-T-4, at 8):

<u>Subscription Type</u>	<u>Number</u>	<u>Extra Scans</u>	<u>Extra ID Codes</u>
Silver	111	37	144
Gold	654	186	364
Platinum	361	N.A.	973

E. Subscription Based Pricing is Appropriate for Confirm.

Confirm, as proposed, employs a novel approach to pricing. Typically, postal products and services are priced per transaction; “[t]he unit charge covers all costs of providing the product, both fixed and marginal, as well as makes a contribution toward the Postal Service’s institutional costs.” USPS-T-5, at 3. While transactional based pricing was explored, ultimately the Postal Service adopted subscription based pricing for Confirm.⁶ With regards to Confirm, subscription based pricing is superior to transaction pricing for the following reasons:⁷

- It would encourage Confirm subscribers to place barcodes on all their mail rather than limiting its use.
- Subscription based pricing is easier to administer than transaction-based pricing, since the Postal Service would only have to bill for a limited number of subscriptions as opposed to every transaction.
- It would simplify Confirm revenue forecasting, since the number of subscriptions would likely be more stable than the number of barcoded pieces mailed.

As referenced above, the Postal Service is proposing to offer Confirm in a three-tiered structure; Silver, Gold and Platinum—as well as service level expansion offered in each tier. USPS-T-5, at Attachment C. These service offerings balance the competing objectives of Confirm by making the service attractive to even the occasional users while generating sufficient revenue to cover Confirm’s total costs. Additional flexibility is found in the service expansion feature. Rather than requiring a subscriber to upgrade from one tier to the next, customers in each tier would be able to purchase additional scans or additional

⁶ The subscription based form of pricing is also advocated by members of MTAC as a means of encouraging higher participation in the service. See USPS-T-2, at 5-6.

⁷ USPS-T-5, at 4-5.

ID Codes.⁸ These optional add-ons allow customers to tailor Confirm to meet their own requirements in a cost-effective manner; it also helps to keep subscription fees down.

Under the current proposal, Confirm will produce revenues of \$9.2 million per year (USPS-T-5, at Attachment D), with a cost coverage of 182%. The proposed pricing adequately covers Confirm's costs and makes a reasonable contribution toward the Postal Service's institutional costs. The Confirm cost coverage for FY 2003, 182%, is within the range of the Postal Service's FY 2003 cost coverage for First-Class letters and Standard Mail mail pieces proposed in Docket No. R2001-1. USPS-T-5, at 10.

II. Conclusion.

The Postal Service has requested that the Commission issue an Opinion and Recommended Decision favoring acceptance of Confirm by the Governors so that the Board of Governors can direct its implementation. Subject to revised DMCS language, the Request is supported by all participants who took any position on the Settlement Agreement. The Settlement Agreement filed with the Commission instead includes new DMCS language that better reflects the salient attributes of Confirm.

WHEREFORE, the United States Postal Service asks the Postal Rate Commission to issue an Opinion and Recommended Decision favoring adoption of Confirm at the fees requested by the Postal Service and relying upon the DMCS language embodied in the Settlement Agreement.

⁸ Subscribers to the Platinum service already receive unlimited scans, so their service expansion option is limited to purchasing additional ID Codes.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Joseph K. Moore

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